

Considerations When Severing Groundwater

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I. Introduction

Groundwater is owned in place² and is severable from the surface estate.³ While historically most groundwater attorneys working in groundwater transactions assumed that groundwater was indeed owned in place and severable from the surface,⁴ it wasn't until *Edwards Aquifer Authority v. Day* that this concept was confirmed. Since *Day*, there has been an increase in the number of severances of the groundwater estate. One reason for the increase may be the legal certainty that *Day* engendered and *Coyote Lake Ranch* extended, but other factors also influence this increase in groundwater severances.

The new 2017 State Water Plan reports that “[m]ost [regional] planning groups recommended the development of at least some additional groundwater.”⁵ Some groundwater-supply strategies involve new wells, but others “may include . . . maximizing the use of existing facilities by . . . conveying groundwater supplies from one provider to another through a purchase.”⁶ Various projects are underway, in various stages, to move groundwater from rural to urban areas of the state. Once the economics of moving water become viable landowners see value in their groundwater as property separate from the land. Increase in perceived value leads to an increase in the number of reservations and severances of the groundwater estate.

The groundwater estate is severed in the same way as a mineral estate – by reservation or conveyance. In *Day* and *Coyote Lake Ranch*, the Texas Supreme Court decided groundwater cases by analogy to oil and gas law. Although it remains early to declare this a definite trend, going

¹ The statements and positions in this paper are solely those of the author and not of Branscomb | PC or its clients. Any inaccuracies are likewise solely those of the author.

² *Edwards Aquifer Authority v. Day*, 369 S.W. 3d 814, 832 (Tex. 2012).

³ *Coyote Lake Ranch v. City of Lubbock*, No. 14-0572, 2016 WL 3176683 (Tex. May 27, 2016).

⁴ *See, e.g. Coyote Lake Ranch*, at *2 (describing how City of Lubbock bought Coyote Lake Ranch's groundwater in 1953 and quoting deed language); *City of Del Rio v. Clayton Sam Colt Hamilton Trust*, 269 S.W. 3d 613, 615 (Tex. App. – San Antonio 2008, pet. denied) (quoting deed language reserving all water rights in 1997).

⁵ Tex. Water Devt. Bd., *Water for Texas, 2017 State Water Plan*, at A-109; *available at* <http://www.twdb.texas.gov/waterplanning/swp/2017/> (last visited Sept. 12, 2016).

⁶ *Id.*

forward transactional water attorneys have a bit more certainty that the courts will treat groundwater similarly to oil and gas. At the same time, parties should also address the differences between the uses and regulatory schemes for water and minerals when they structure their transactions.

A variety of factors might bring about a decision to sever the two estates. A common reason to sever is a seller's desire to retain the economic value of the groundwater estate for himself upon sale of the surface. Estate planning is another reason a property owner might sever the surface and groundwater estates while retaining ownership of both, perhaps conveying the surface and/or groundwater estate to its own special-purpose limited liability entity. Other reasons include allowing a vehicle to make gifts to children either at the time of the severance or by will, or allowing for investors in groundwater projects while retaining the use of the surface in a more traditional manner. There may even be the potential to use the common conservation easement for severed water, alone.

Now that severance of the groundwater estate has become an almost routine consideration in sophisticated rural land transactions, the value and significance of the groundwater estate should be considered as early as possible in a transaction. Gone are the days when it was safe to assume that all of the groundwater estate would be conveyed along with the surface. Parties entering into a land transaction should expect to discuss how much of the groundwater estate is being conveyed and on what terms.

What are the implications of severing groundwater from the surface? What should parties consider as they negotiate deal terms, deed language, surface-use provisions, liability matters, groundwater uses remaining with the surface, easements, transportation, and uses of the surface that don't conflict with the severed water?

II. Deal Terms

A. *Thoughts about Value*

At the time of a land sale, the seller might want to reserve all or part of the groundwater estate, offering the surface at one price and the surface plus groundwater at another. Or a landowner might convey all or a portion of his groundwater estate, and the parties must define groundwater value at that point. A surface owner, or potential surface owner, facing this situation must decide

how valuable the property is to him with and without the groundwater, and the parties must determine a price for the groundwater. Although there are usually easily-accessible resources to determine land values, there are fewer resources available to determine the value of the groundwater estate. The value will depend on the uses and value of the land with and without groundwater and the location of the groundwater in relation to any proposed project or end consumer.

B. Thoughts about Rights Conveyed and Reserved

The parties should determine at the outset of their transaction which rights will be conveyed and which will be reserved. The groundwater owner (whether a seller reserving groundwater or a buyer purchasing groundwater and groundwater rights) should determine what the goals are for the groundwater, and the surface owner should determine what water rights and uses he must retain. Any agreement to this effect should specify that its terms supersede common law to the contrary. The following is a non-exhaustive list of considerations that should be discussed and agreed to in a groundwater transaction.

- 1. How will the parties define the groundwater and groundwater rights to be conveyed or reserved?** Will the groundwater include every possibly molecule below a given tract of land, or will it be limited to certain aquifers or formations? In the case of a groundwater conveyance where a seller is keeping the land, the parties might discuss whether the transaction could be limited to the groundwater underlying a specific portion of the seller's land, thereby preserving some of the seller's surface free of groundwater development.
- 2. Does the transfer of groundwater rights need to include reference,** either generally or specifically, to permits issued by a groundwater conservation district or other governmental entity? This consideration applies even in an area that lacks groundwater regulation at the time of the severance, because a regulatory body could someday be formed.
- 3. What groundwater rights will be conveyed to or retained by the surface owner?** If the surface owner uses or will use groundwater, the parties should define which rights to the groundwater remain in or are conveyed to the surface owner. If there will be no cost to the surface owner for these uses that should be stated. The following possible groundwater rights should be considered for the surface owner:

- a. Domestic and livestock uses will commonly be allowed for the surface owner and the parties should define these terms.
 - b. May the surface owner drill new wells? If so, of what type? Will surface owner be limited to low-capacity wells?
 - c. Is the surface owner restricted to uses of the groundwater at the time of the severance?
 - d. May the surface owner fill tanks and ponds?
 - e. May the surface owner continue existing or historic uses of groundwater, including high-intensity uses like irrigation, if applicable?
 - f. How should water use for oil and gas exploration be accounted for?
 - g. What remedies does the surface owner have against the groundwater owner for damage caused to the surface owner's groundwater use? Will the groundwater owner replace or rework the well or lower the pump? Can the parties agree on the remedies now, or should they also include alternative-dispute-resolution provisions?
- 4. Is the future groundwater owner willing to waive access rights to the surface?** The surface owner should be aware that under *Coyote Lake Ranch*, even a simple reservation of the groundwater is enough to secure the groundwater holder's rights to use as much of the surface estate as is reasonably necessary to produce the groundwater.⁷ Under certain circumstances, a groundwater owner might be willing to waive rights of ingress and egress. If so, the surface owner should have the groundwater owner execute and record a surface waiver agreement to that effect. The surface waiver agreement would be similar to those used in oil and gas transactions.
- 5. Surface use considerations** The surface owner should determine under what terms he is comfortable with the groundwater owner developing the groundwater. The parties should include those details regarding the use of the surface for groundwater production in their deed or execute a surface use agreement regarding those terms. Considerations should include:
- a. What, if any, compensation will the groundwater owner pay to the surface owner for damage to property caused by its operations?

⁷ See *Coyote Lake Ranch*, at *9.

- b. What, if any, compensation will groundwater owner pay to surface owner for well sites? When compensation is owed, how, if at all, will the price be adjusted for inflation over time?
- c. Will surface owner have the right to purchase or receive free of charge any facilities or unused wells constructed by groundwater owner?
- d. Under what terms may groundwater owner construct pipelines?
- e. Under what terms may groundwater owner construct roads?
- f. Under what terms may groundwater owner construct or have constructed utility lines?
- g. What terms will be put on use of, and care for, existing roads, gates, and fences?
- h. Will there be any limits on locations for facilities or wells?
- i. What other details might be of specific importance to surface owner? Examples: trees, riparian areas, historic areas, litter cleanup, rules about hunting/hunting season/firearms?
- j. Does the groundwater owner need the surface owner to maintain certain conditions to protect the groundwater as a public water supply?

6. Regulatory considerations

- a. Who will pay any fees of a groundwater conservation district?
- b. Will the parties be splitting existing groundwater-conservation-district permits? If so, how will that be accomplished?
- c. What happens if the surface owner's use of groundwater is counted toward the groundwater owner's production limits under groundwater conservation district rules?
- d. What will the parties file with the groundwater conservation district so that it is aware of the parties' rights in groundwater and the permits?

C. Reserving "commercial production"

When it remains unclear whether and when the groundwater estate will become valuable for uses off the property, a reserver of groundwater may desire only to reserve a right to the proceeds of any commercial sales of groundwater in the future. This type of reservation might take the form

of a non-participating royalty interest like that used in oil and gas transactions. The non-participating royalty would secure all or a share of the proceeds for the reserving party in the future.

D. Considering the Mineral Estate

When groundwater is severed, the parties should take the opportunity to evaluate the relationship between the groundwater estate and the mineral estate. *Coyote Lake Ranch* acknowledged that a severed groundwater estate is dominant to the surface in the same way as the mineral estate.⁸ It remains unclear, however, how conflicts between the groundwater and mineral estates (both dominant to the surface estate) will be resolved.⁹

If the mineral estate has already been severed and leased, and minerals are already being produced, some parameters of the concerns regarding the relationship between the groundwater and mineral estate's use of water will have already been laid out. Depending on the terms of the mineral lease, the mineral owner may have rights to use water on the property for mineral development. Careful parties will take into account the relationship between the mineral and groundwater estates when negotiating and drafting their agreement. If severed groundwater and mineral estates come into conflict, rights in the groundwater estate will likely be subject to the rights of the mineral interest holder, because it came first in time, and the groundwater owner should have been on notice of the existing mineral ownership/lease/use of water. However, this fact scenario has yet to be analyzed by a court.

Where the entire "bundle of sticks" is intact and there is no mineral lease in effect or contemplated, the parties to a severance transaction should discuss whether and how to subordinate the mineral estate's rights to use water to the rights of the groundwater owners. Determining in advance the priority of groundwater rights between the mineral and surface estate would be especially relevant if the potential for groundwater development was likely to occur before any mineral development.

III. Thoughts about *Coyote Lake Ranch*

A. *Summary of the Case*

⁸ *Id.* at *14.

⁹ *Id.* at *17, fn 55 ("The City questions whether the accommodation doctrine is workable when both the minerals and the groundwater have been severed from the land. We leave that issue for another day.").

If parties to a groundwater transaction intend for their agreements to supersede common law to the contrary, they should carefully spell that out. This is especially important after the result in *Coyote Lake Ranch*. The deed in that case granted the groundwater owner expansive rights to develop groundwater on the property, but the court found the deed’s language ambiguous enough that it went outside the parties’ agreement to resolve disputes between the parties about the use of the surface.

In *Coyote Lake Ranch*, the Ranch’s predecessor in interest (the Ranch and its predecessor will henceforth be called “the Ranch”) had conveyed the groundwater estate under the ranch to the City of Lubbock (“the City”) in 1953.¹⁰ The Ranch retained certain rights to use groundwater, but the bulk of the groundwater estate and right to develop it were conveyed to the City. Over the years, the City drilled a few wells on the Ranch, but did not begin large-scale groundwater development plans for the property until 2012.¹¹

The groundwater deed gave the City expansive rights to drill “water wells and test wells” “at any time and location” on the Ranch, and “to use all that part of [the Ranch] necessary or incidental to the taking[,] production, treating [,] transmission[,] and delivery of ... water”.¹² The deed also gave the City rights to “construct certain specified facilities, including water lines, fuel lines, power lines, communication lines, barricades, and access roads ‘on, over and under said lands necessary or incidental to any of said operations’ . . .”.¹³

In 2012, the City drew up plans to drill many new wells on the property, along with roads and power lines. The Ranch complained that the City’s proposed road construction would cause erosion on the sandy hilltops and the proposed power lines would threaten the Lesser Prairie Chicken. The Ranch sued the City to enjoin its mowing activities, arguing that the City had a duty “to use only that amount of surface that is reasonably necessary to its operations’ and that the City had a ‘duty to conduct its operations with due regard for the rights of the surface owner.’” The trial court granted the Ranch’s request for a temporary injunction and enjoined the City from

¹⁰ *Id.* at *2.

¹¹ *Id.* at *4.

¹² *Id.* at *3, fn 6.

¹³ *Id.*

mowing grass, drilling wells without consulting the Ranch, or erecting power lines to proposed well fields.¹⁴

The City appealed, arguing that it had rights under its deed to pursue its groundwater-development plan and that the accommodation-doctrine claim brought by the Ranch did not apply to groundwater law. The Ranch argued that as a logical extension of the ownership-in-place holding in *Day*, the accommodation doctrine also applied to severed groundwater estates. The court of appeals agreed with the City and reversed the temporary injunction.¹⁵

On appeal to the Supreme Court, the Court first evaluated whether the City's deed resolved the issue between the parties, as the accommodation doctrine would only apply in the absence of an applicable agreement. The Court found that "the deed leaves unclear whether the City can do everything necessary or incidental to drilling anywhere, as it claims, or only what is necessary or incidental to fully access the groundwater, as the Ranch argues." The Court found a similar ambiguity regarding overhead power lines and held that the deed did not resolve the parties' dispute.¹⁶

The Court then turned to oil and gas law and explained how and why a severed mineral estate is dominant to the surface. In light of this relationship, the accommodation doctrine serves to balance the competing interests of the mineral and surface estate owners. The court analogized the groundwater estate to a mineral estate to hold that the accommodation doctrine also applies in groundwater law. In the course of reaching that holding, the Court confirmed that a severed groundwater estate is dominant to the surface in the same way as a severed mineral estate.¹⁷

In conclusion, after holding that the accommodation doctrine would apply to resolve the parties' dispute, the Court analyzed the trial court's temporary injunction and found it overbroad. It therefore affirmed the judgment of the appellate court reversing the temporary injunction and remanded for further proceedings consistent with its opinion.¹⁸

B. Takeaways

¹⁴ *Id.* at *4-6.

¹⁵ *Id.* at *6-7.

¹⁶ *Id.* at *8.

¹⁷ *Id.* at *9-15.

¹⁸ *Id.* at *17-18.

The obvious takeaway from *Coyote Lake Ranch* is that the accommodation doctrine applies as between surface and groundwater owners. Based on the dearth of accommodation-doctrine cases in oil-and-gas law, it seems unlikely that this will become a busy area of groundwater litigation.¹⁹

Another big takeaway is the confirmation that the groundwater estate is dominant to the surface. The Court cited this dominance as a settled, uncontroversial point,²⁰ but it took some water lawyers by surprise. In the absence of a clear statement by the Supreme Court to this effect in the past, transactional water lawyers had structured deals and drafted documents as though a groundwater owner would not have had the same implied rights of ingress and egress afforded to mineral owners. Now that this point is clarified, it will inform future water deals, though savvy lawyers will still draft careful documents regarding surface use.

Another, less splashy, takeaway from *Coyote Lake Ranch* is that lawyers should draft groundwater deed language with great care to avoid ambiguity. This general principle applies in every transaction of every type, but the *Coyote Lake Ranch* decision gives special guidance in the groundwater context. If the seemingly broad language of the City's deed does not give expansive development rights, then what does?

Specifically, the relevant portion of the deed stated:

[Grantor conveys groundwater] together with the full and exclusive rights of ingress and egress in, over, and on said lands, so that the Grantee of said water rights may *at any time and location drill water wells* and test wells on said lands for the purpose of investigating, exploring producing, and getting access to percolating and underground water; together with the rights to string, lay, construct, and maintain water and fuel pipe lines and trunk, collector, and distribution water lines, power lines, communication lines, air vents with barricades, observation wells with barricades, if required, not exceeding ten (10) square feet of surface area, reservoirs, booster stations, houses for employees, and access roads on, over and under said lands necessary or incidental *to any of said operations . . .*²¹

The opinion states the deed is “simply silent” on whether “the City can do everything necessary or incidental to drilling anywhere . . . or only what is necessary or incidental to fully access the groundwater.”²² But the deed actually says “necessary or incidental to any of *said operations*,”

¹⁹ See *id.* at *14 “The paucity of reported cases applying the doctrine suggests that it is well-understood and not often disputed.

²⁰ *Id.* at * 14, citing *Evans v. Ropte*, 96 S.W.2d 973, 974 (Tex. 1936).

²¹ *Coyote Lake Ranch*, at *8 (emphasis added).

²² *Id.* at *8.

referring back to a long list of operations including drilling wells and constructing power lines. The Court did not give guidance on how this could have been clearer, but further guidance would be helpful to transactional water attorneys. The City has filed a motion for rehearing requesting clarification as to this and other points.²³

IV. Conclusion

Severances of the groundwater estate are becoming more common, and it seems likely that our courts will continue to treat severed groundwater like oil and gas. As these trends continue, we will see more fractional ownership of groundwater. Parties to rural land transactions should take special care in determining their deal terms regarding groundwater, especially if the groundwater is to be jointly managed.

²³ Respondent's Motion for Rehearing , Coyote Lake Ranch v. City of Lubbock, No. 14-0572, 2016 WL 3176683, (Tex. Aug. 2, 2016).